

Message Text

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PAGE 01 LONDON 12463 01 OF 02 281708Z
ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 EURE-00 AID-05 CIAE-00
COME-00 EB-08 FRB-03 INR-07 NSAE-00 USIA-06
XMB-02 OPIC-03 SP-02 LAB-04 SIL-01 OMB-01 NSC-05
SS-15 STR-04 CEA-01 PRS-01 PA-01 /089 W
-----117941 281724Z /47

P R 281533Z JUL 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 6596
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 12463

USOECN ALSO FOR EMBASSY
USEEC

E.O. 11652: GDS
TAGS: EFIN, UK
SUBJECT: POUND AND UK FINANCIAL POLICY

REF: LONDON 12392

SUMMARY: MAIN INTENT OF CHANGE IN HMT/BANK OF ENGLAND
INTERVENTION POLICY IS TO RESTORE POUND'S TRADE WEIGHTED
DEPRECIATION LEVEL TO ROUGHLY 62; I.E., LEVEL THAT EXISTED
BEFORE DOLLAR'S RECENT DECLINE. END SUMMARY.

1. FINANCIAL ATTACHES CALLED ON RUSSELL BARRATT, DEPUTY
SECRETARY AT HMT IN CHARGE OF OVERSEAS FINANCE/EXCHANGE
RATE CONSIDERATIONS. ALSO PRESENT ON UK SIDE WERE DAVID
HANCOCK, UNDER SECRETARY, AND MALCOLM GILL, ON SECONDMENT
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PAGE 02 LONDON 12463 01 OF 02 281708Z

FROM THE BANK OF ENGLAND, WHO WORKS ON EXCHANGE RATE
MATTERS. BARRATT EXPLAINED RATIONALE IN PERMITTING THE
POUND TO RISE AGAINST THE DOLLAR, SAYING HMT HAD BEEN
CAPPING THE POUND AT ROUGHLY \$1.7170 TO \$1.7200 WHICH, AS
A RESULT OF DOLLAR WEAKNESS, CAUSED THE TRADE WEIGHTED
DEPRECIATION TO WIDEN. THE AIM OF ALLOWING THE POUND TO
RISE AGAINST THE DOLLAR IS TO RESTORE THE EFFECTIVE TRADE

WEIGHTED DEPRECIATION TO A HIGHER LEVEL. IN REPLY TO A QUESTION, BARRATT INDICATED THIS WOULD BE IN THE 62 RANGE (RECALL THAT IN RECENT WEEKS THE EFFECTIVE RATE HAD DECLINED ALMOST 2 PERCENT, FROM 61.6 IN EARLY JUNE TO 60.6 ON JULY 26).

2. BARRATT STRESSED THAT THERE HAD BEEN DETAILED PRESS BRIEFINGS AND THAT THE PRESS THIS TIME "HAD GOT IT RIGHT." THE AIM WILL BE TO SEEK GENERAL STABILITY IN THE TRADE WEIGHTED FIGURE. HANCOCK SINGLED OUT STATEMENTS IN THE LEX COLUMN OF THE FINANCIAL TIMES OF JULY 28; "THE BANK IS ANXIOUS TO POINT OUT THAT IT HAS NOT BEEN SUDDENLY CONVERTED TO THE INTERNATIONAL MONETARIST SCHOOL OF THOUGHT. STERLING IS NOT TO FLOAT FREELY: IT IS SIMPLY BEING UNPEGGED FROM A WEAK DOLLAR...IT WILL PROBABLY EMERGE IN THE NEXT FEW DAYS JUST WHERE THE BANK THINKS THE PEG SHOULD NEXT BE INSERTED-- WHETHER FOR INSTANCE, THE WHOLE OF THE EFFECTIVE DEVALUATION OF 2 PERCENT OR SO SINCE EARLY JUNE SHOULD BE REVERSED."

3. DURING CONVERSATION, HANCOCK NOTED THAT WHEREAS THE EFFECTIVE RATE IS MADE PUBLIC BY THE BANK OF ENGLAND THREE TIMES A DAY, IT CAN BE COMPUTED ALMOST INSTANTANEOUSLY FOR INTERNAL PURPOSES. THUS, ALTHOUGH AIMING AT A MORE STABLE EFFECTIVE RATE WHILE USING THE DOLLAR AS AN INTERVENTION CURRENCY WAS COMPLEX, IT COULD BE DONE.
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PAGE 03 LONDON 12463 01 OF 02 281708Z

4. BARRATT SAID THAT ALTHOUGH THERE HAD BEEN LENGTHY INTERNAL DISCUSSIONS ON THE NEW POLICY THE POSSIBILITY OF

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PAGE 01 LONDON 12463 02 OF 02 281710Z
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SS-15 STR-04 CEA-01 PRS-01 PA-01 /089 W
-----117967 281723Z /47

P R 281533Z JUL 77
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TO SECSTATE WASHDC PRIORITY 6597
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 12463

REJOINING THE EC SNAKE NEVER AROSE DURING ANY OF THEM.
THIS IS NOT UNDER CONSIDERATION. NOR DID BARRATT BELIEVE
THE CHANGE IN POLICY WOULD HAVE ANY APPRECIABLE IMPACT ON
UK COMPETITIVENESS OR COMMITMENTS UNDER THE IMF LETTER OF
INTENT. THE AIM IS NOT TO IMPROVE STERLING'S OVERALL
POSITION, BUT RATHER TO RESTORE IT TO ITS PREVIOUS LEVEL.

5. ONE EFFECT OF CHANGE IN POLICY HAD BEEN TO STRENGTHEN
GILTS AND THE STOCK MARKET. WAS ONE OF THE UK AIMS TO
CONTROL THE MONETARY IMPACT OF CAPITAL INFLOWS AND TO
CREATE BETTER MARKET CONDITIONS FOR THE SALE OF GILTS?
(SEE PARA 6, REFTTEL) BARRATT SAID THIS WAS NOT A SIGNIFI-
CANT ELEMENT IN THE UK DECISION.

6. BARRATT, SHIFTING FOCUS OF THE CONVERSATION, SAID HE
WAS AMAZED TO HEAR THAT DEALERS WERE SELLING DM IN ORDER
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PAGE 02 LONDON 12463 02 OF 02 281710Z

TO GET INTO STERLING, EVEN IF ONLY FOR ARBITRAGE. LOOKING
LONGER AHEAD, BARRATT ACKNOWLEDGED THAT THE UK CURRENT
ACCOUNT SHOULD BE SHOWING STEADY AND GROWING IMPROVEMENT
IN COMING MONTHS AS A RESULT OF NORTH SEA OIL, PROVIDING
THERE IS NO OFFSETTING EXPLOSION OF IMPORTS.

7. AS A RESULT, RESERVES COULD BE EXPECTED TO INCREASE
AND DECISIONS WOULD HAVE TO BE TAKEN ABOUT WHAT TO DO WITH
THEM. THE UK DOES HAVE OBLIGATIONS TO LIBERALIZE CAPITAL
MOVEMENTS TO THE EC. (FINANCIAL ATTACHE INTERJECTED THAT
HE HOPED ANY LIBERALIZATION WOULD EXTEND TO ALL OECD MEM-
BERS UNDER COMMITMENTS IN THE CODE OF LIBERALIZATION OF
CAPITAL MOVEMENTS.) BARRATT EXPLAINED UK HAS A DEROGATION
WITH THE EC WHICH IT WILL PROBABLY SEEK TO CONTINUE IN OR-
DER TO USE FUTURE INCREASE IN RESERVES TO REPAY VERY HEAVY
DEBT SERVICE DUE IN THE EARLY 1980S. SIGNIFICANT LIBERALI-
ZATION OF CAPITAL IS PROBABLY A CONSIDERATION FOR THE MID
1980S RATHER THAN THE NEAR FUTURE.

8. BARRATT REMARKED THAT STERLING'S IMPROVED RELATIVE POSITION AGAINST THE DOLLAR MIGHT MAKE IT MORE ATTRACTIVE AS A HOME FOR MOBILE CAPITAL FLOWS. HE HOPED NOT. HE SPECIFICALLY SAID HE LOOKS FORWARD TO THE UK LOSING ITS RESERVE CURRENCY STATUS ENTIRELY--AN ALLUSION TO THE BASLE AGREEMENT--AND WOULD BE FRIGHTENED TO SEE A BUILD UP OF STERLING BY FOREIGN HOLDERS. HE HOPED THE UK HAD LEARNED ITS LESSON ON THIS POINT.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCIAL PROGRAMS, DEVALUATIONS, POUND (CURRENCY), FOREIGN EXCHANGE RATES
Control Number: n/a
Copy: SINGLE
Sent Date: 28-Jul-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON12463
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D770270-1065
Format: TEL
From: LONDON USOECD
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770710/aaaaahxe.tel
Line Count: 178
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 4bed8662-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 77 LONDON 12392
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 02-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1719602
Secure: OPEN
Status: NATIVE
Subject: POUND AND UK FINANCIAL POLICY
TAGS: EFIN, UK
To: STATE TRSY
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/4bed8662-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009